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Understanding Active Loyalty in Hotel Reward Programs through Customers' Switching Costs and Perceived Program Value

Karen Xie
Temple University, hmkaren@temple.edu

Lina Xiong
Temple University, lina.xiong@temple.edu

Chih-Chien Chen
Temple University, ccchen@temple.edu

Clark Hu
Temple University, clark.hu@temple.edu

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Abstract

The hotel industry continues embracing loyalty/rewards programs as a major platform to nurture customer relationships as well as reap return business. The reality is that major hotels have been aggressively spending more but achieve less in defending existing customers. We address this void by examining the structural relationship among perceived program value, switching costs and active loyalty. The proposed model is supported by a unique dataset comprised 188 hotel customers who participated in a online survey. The study distinguishes the impact between perceived program value and switching costs, showing a stronger role of switching costs on active loyalty compared to perceived program value. It also empirically investigate program value signals that affect switching costs, and identify the stable role of switching costs when holding. The findings contributes to the body of hospitality literature and has managerial implications for the industry practice.

Introduction

Loyalty programs are commonly used to encourage customers' repeated patronages via rewarding such behaviors (Lewis, 2004). A fine designed loyalty program can increase repeat purchase, willingness to pay premiums, promoting positive Word-of-Mouth, and share of wallet (Keh & Lee, 2006; Leenheer, Heerde, Bijmolt, & Smidts, 2007; McCall & Voorhees, 2010). Thus, various companies are spending extensive effort on establishing an effective loyalty program. In a typical loyalty program implementation process, marketers need to promote program awareness, convey program value to potential members, encourage customers to join the loyalty program, build a loyalty customer information database, and spend more effort on rewards management (Ferguson & Hlavinka, 2007).

However, having a loyalty program does not ensure customer loyalty, especially maintaining the active loyalty. The zero entry fees of most loyalty programs promote customers involved in multiple loyalty program memberships. The 2006 COLLOQUY loyalty marketing census revealed that the average US household belongs to approximately 12 loyalty programs (Ferguson & Hlavinka, 2007). Many researchers have posited doubt on whether loyalty programs actually work (e.g., Dowling & Uncles, 1997; O'Brien & Jones, 1995). They argued that many of the establishments of loyalty programs were in fact copying behaviors and loyalty programs in marketplaces where lacked enough understanding in customer needs and desires. The 2006 COLLOQUY loyalty marketing census further supported the unsatisfying performance of loyalty programs. Out of the 1.3 billion loyalty program memberships, approximately only 40 percent were active involved (Ferguson & Hlavinka, 2007). Nonetheless, the airline loyalty programs are being criticized as frequent-buyer programs rather than frequent-flier programs because only about 11 percent of airlines reward miles are being redeemed on average (Greenberg, 2008).

Such results suggested much more understanding be required for the gap between the loyalty program marketers' expectations and the actual customer perceptions of the program values.

There are many potential factors that can affect a customer's evaluation of a certain loyalty program. For example, the design of the loyalty program, reward structure, and customer-program fit (McCall & Voorhees, 2010). Several studies were devoted to designing a successful loyalty program from perspectives such as program tier design and reward medium maximization problems (Hsee, Yu, Zhang, & Zhang, 2003; Nunes & Drèze, 2006). However, little is known from customers' perspectives. In other words, how do customers evaluate a loyalty program based on its characteristics? If customers are attracted to the loyalty program, what makes customers retain in the loyalty programs? What is the relationship between their evaluation of the program and their subsequential purchase behaviors? What are the determinants affecting customers' considerations in switching their loyalty behaviors to another brand? This study is set to answer such questions. Specifically, the purpose of the proposed study is three-fold: 1) to examine the customers' active loyalty, perceived program value and switching costs with respect to loyalty programs, 2) to identify the relationship of perceived quality and switching costs for customers to retain in the loyalty program, and 3) to provide information to hospitality industry on how to attract and retain customers in the loyalty program.

Literature review

Customer Perceived Program Value. Retailers often struggle to understand what customers value is because customers are naturally value-driven and their perceived value is directly connected to their purchase choices (Sweeney & Soutar, 2001). Customers' perceived value of a product can be viewed as the tradeoff between what the product can offer to the

customer and what the customer has to pay to get the product (Sweeney & Soutar, 2001; Zeithaml, 1988). Normally, price and quality are the two primary components in evaluating a certain product. However, besides the functional value of the product, researchers further proposed other value dimensions important influencers of customers' choices (Babin & Burns, 1998; Sheth, Newman, & Gross, 1991; Sweeney & Soutar, 2001). Such propositions provide valuable insights in formating how customers evaluate a hotel loyalty program. Lewis (2004) suggested that a working loyalty program structure should motivate customers to continue purchasing and accumulating rewards. McCall and Voorhees (2010) proposed an conceptual model to evaluate loyalty program effectiveness through the structure of loyalty program, structure of rewards, and customers factors. Customers possess different perceptions towards different loyalty program characteristics and different status. For example, customers place much greater value when closer to earning a reward and they tend to place less value on a reward at the beginning of the program (Hartmann & Viard, 2008). In effect, when the value of accumulated spending increases and the expiration date for reward redemption approaches, customers are more likely to increase their purchases (Lewis, 2004). Dowling and Uncles (1997) suggested six components in determining the program value evolved from the proposistions from O'Brien and Jones (1995). Based on this proposition, Kim, Kim, and Leong (2003) further adatped the value deminsions into several criteria to evaluate the hotel and airline loyalty programs. Since how customers use the loyalty program to book room-nights, accumulate loyalty points, and redeem reweards is closely to their perceived value of the program, to understand how customers value each program creteria is crucial in establishing an effective loyalty program that can promote customers' active loyalty.

Hypothesis 1: Greater perceived values will be associated with higher active loyalty.

Switch Cost. Switching costs is defined as the perceived economic and psychological costs associated with changing from one alternative to another (Jones, Mothersbaugh & Beatty, 2002). Although many markets are featured with substantial costs of switching from a product (or a service) to a competing product, switching costs are rarely mentioned and practiced in hotel industry. Switching costs not only foster greater customer retention but also help firms' short-term fluctuations in service quality that might otherwise result in defection. Study (Chen & Hitt, 2005) demonstrates that firms can benefit from investments or actions that affect customers' perceived switching costs. Hence, this study proposes:

Hypothesis 2: Greater switching costs will be associated with higher active loyalty.

Active Loyalty. Hotel loyalty programs are meant to attract customers' active loyalty rather than passively being a member, or shopping around for other alternatives. Much of the managerial literature on customer retention uses retention rate as a measure of customer loyalty or consumer switching costs and does not make a distinction between switching cost and value in driving retention (see. e.g., Reichheld & Schefter, 2000). This approach becomes problematic when one is interested in the drivers of customer retention or how investments in specific practices can improve (or decrease) retention. An excellent hotel loyalty program might perform poorly if customers face high switching costs but most customers have already adopted alternatives. This suggests the following hypothesis to test the relative effects of perceived program value and switching costs in driving active loyalty.

Hypothesis 3: Switching costs associate more strongly with active loyalty than perceived program value

Research Methodology

Based on extensive literature reviews, the authors developed the survey instrument focusing on three major customer-based constructs and factor-analyzed to identify each construct's final latent variables: perceived loyalty program values (13 latent variables), perceived switch costs (11 latent variables), and active loyalty (6 latent variables) respectively. The questionnaire also inquired customers' demographic information and their hotel loyalty program usage patterns, such as the number of loyalty program memberships, the most loyal membership program, and the length of such loyalty membership. Online survey method was utilized to collect data with the participative incentive of three vegas.com gift cards valued at $100 each via a random drawing. Respondents were randomly selected from a US national sample frame of travelers who previously requested tour information of domestic destinations. After three weeks of online survey period, about two percent of response rate was achieved and 188 valid responses were collected.

To answer the intended research questions, a series of statistical procedures were adopted: a descriptive analysis was first conducted to understand respondents' general profile, followed by an principal component analysis to understand underlying dimensions of interested factors, then a structure equation modeling (SEM) technique was conducted to path-analyze the hypothesized model as well as better understand the observed relationships. Two competing models were carefully analyzed at the last stage: models with and without controlling variables. Due to the space concern for the conference paper, only the full model (controlled for various variables such as number of memberships, tourist types, demographics, etc.) is reported here.

Respondent General Profile: The average age of the sample was 52.4 and the majority (64 percent) were females. 53 percent of the participants held an undergraduate degree or higher. Half of the sample reported their anunal household income above $80,000. About two-third of the sample self-identifed as leisure travelers. On average, the participant has consumed 12 room-nights in the past 12 months. In terms of hotel loyalty program usage patterns, many seemed to maintain a longer-term relationship with their loyal programs. The average length of the most loyal relationship was almost four years (45 months). Of the participants who identified the most loyal program, 22 percent did not know their membership level whereas 50 percent held the basic membership compared with 28 percent elite membership status. On avarage, respondents reported to have appoximately three different hotel loyalty program memberships. 73 percent of the respondents also were members of airline programs.

Exploratory and Confirmatory Factor Analyses: First, a three-factor solution was achieved through 26 items of perceived program value. Similarly, 20 items of switching costs showed a stable solution of three factors. Second, CFA was used to assess the fit of the factor solution following the methods proposed by Anderson and Gerbing (1988). Measurement validation of the study and the correlation matrix exhibited adequate reliability scores and convergent and discriminant validity. The relationships among three constructs were examined using structural equation modeling. Recommended by Pratt (1976) and Byrne (1994), a maximum likelihood (ML) estimation method with the aid of AMOS was employed to estimate the structural model.

EFA Solution

Following the previous recommendations (Cattel, 1966), the principle component factor analysis with varimax rotation was conducted to extract factors and check the underlying dimensions of perceived program value (PPV) and switching costs (SC). The Kaiser-Meyer-Olkin measure of sampling adequacy (.848 for PPV and .876 for SC) and Bartlett's test of sphericity (p<.001) confirmed the appropriateness of EFA. Two criteria were used to determine the factor structure: (a) retaining items with a factor loading equal to or greater than .40, and (b) excluding items cross-loading on two or more factors. A three-factor solution is adopted, explaining 65.26% of the total variance for perceived program value and 64.66% for switching costs. The eigenvalue for all the factors are greater than 1.0 (Kaiser, 1970), respectively. The results provided strong evidence of construct validity (Churchill, 1979).

The first factor of PPV consists of six items, explains 26.83% of the total variance, and its factor loadings range from 0.69 to 0.83. Examples of items are "Easy to achieve reward redemption" and "Points I have accumulated never expire". The items from this factor had a Cronbach's alpha of 0.89. As the factor's strongest loading items linking to the functional usage and characteristics of the hotel loyalty programs, it was named "Functional Value." The second factor, consisting of six items and explaining 23.08% of the total variance with factor loadings range from 0.52 to 0.84, is named "Pychological Value." Item examples were "Proud of being a member", "Privileges offered at an elite level" and "Easy to upgrade to a higher elite level". Its Cronbach's alpha reached .858. The third factor included three items of "Convenience to transfer my reward points to someone I know", "Ability to transfer points to someone I know" and "Ability to combine hotel points and airline miles", featuring the "Economic Value" of the hotel loyalty programs. This factor explained 16.33% of the total variance and its factor loadings ranged from 0.65 to 0.95. Its Cronbach's alpha was 0.857.

Similarly, the first factor of SC was named "Psychological Switching Costs" because its items strongly loaded on the emotional and psychological loss if consumers switch their hotel loyalty programs. Four items were loaded on this factor including "I appreciate the brand image of my "old" program." and "I feel that I belong to my "old" program." It explained 23.09% of the total variance and its factor loading ranged from 0.62 to 0.81. The Cronbach's alpha was .835. The second factor of SC consisted of five items, explaining 22.36% of the total variance with factor loadings ranging from 0.74 to 0.87 and Cronbach's alpha of .78. This factor was then named "Procedural Switching Costs" with items such as "The new program is easy to get familiar with." and "The new program takes little time and efforts to evaluate." The third factor was named "Financial Swtiching Costs," including items such as "The new program involves hidden costs/charges." and "The points I have accumulated in my "old" program will not be retained." They explained 19.20% of the total variance with factor loadings ranging from 0.67 to 0.85 and a Cronbach's alpha of .771. In sum, factors are meaningfully labeled in accordance with their item loadings.

CFA Solution

Confirmatory Maximum Likelihood Factor Analysis was then used to test the goodness of fit of three-factor models of the structure of PPV and SC. As numerous fit statistics consider different aspects of fit, it has been recommended that researchers should report multiple fit statistics in structural equation model studies (Thompson, 2000). For this reason, four indices were incorporated to assess the degree to which the data fit the model: the ratio of chi-square to degree of freedom (x^2/df) (Carmines & McIver, 1981), the root mean square error of approximation (RMSEA), the Tucker Lewis Index (TLI), and comparative fit index (CFI) (Hu & Bentler, 1999). The results indicate a robust goodness of fit to the data ($\chi^2_{(234)}$ =473.22, p=.00,

RMESA=0.074, TLI=0.898, CFI=0.913), supporting treating the six latent variables identified by the EFA as unidimensional first-order factors of PPV and SC.

Table 2 presents the Cronbach's alphas used to estimate the reliability of the multi-item scales: PPV1/Functional Value (.89), PPV2/ Psychological Value (.86), PPV3/Economic Value (.86), SC1/Psychological Switching Costs (.84), SC2/ Procedural Switching Costs (.78), SC3/ Economic Value (.77), and AL/Active Loyalty (.88). All of the alpha coefficients were above the cut-off point of .7 (Nunnally, 1978), indicating an acceptable level of reliability for each construct.

Following the methods proposed by Anderson and Gerbing (1988), convergent and discriminant validity of the scales were examined. Convergent validity was supported by the evidence that all average variance extracted (AVE) exceeded .5 (Fornell & Larcker, 1981). Additionally, the CFA results lent further support for the convergent validity of measures since estimated loadings for all indicators in Table 3 were significant at $p<.000$ (Anderson & Gerbing, 1988). Also, an AVE for each construct is greater than squared correlation coefficients for corresponding inter-constructs, which confirmed discriminant validity (Fornell & Larcker, 1981).

Path Analyses and Hypothesis Testing

The relationships between the constructs were examined using structural equation modeling. The results of the final CFA model with control variables supported two hypotheses: on the effect of switching cost to active loyalty (H2), thus greater switching costs is associated with higher active loyalty. The Hypothesis 3 on the effect of perceived program value to switching costs was partially supported. Specifically, the effects of functional value (Hypothesis 3a) and psychological value (Hypothesis 3b) on switching costs were supported, while the effect of economic value on switching costs was not supported (Hypothesis 3c). When holding control variables, perceived program value was not found statistically significant in predicting switching costs. This finding reflects the critical role of switching costs in

affecting customers' active loyalty in the study. Figure 2 illustrates the relationships of the SEM results and Table 4 presents relevant statistics from the CFA model.

With respect to testing the relationships between "controlled" characteristics (demographics and program usage pattern) and active loyalty, tourist type was the only control variable showing a significantly positive effect on active loyalty ($\gamma = .14$, $t = 2.23$, $p<.05$). However, another control variable "age" was found to have a significantly negative effect on active loyalty ($\gamma = -.14$, $t -= -2.38$, $p<.05$). No other significant relationships were found between other controlled characteristics and active loyalty.

Discussion

The study examines the structural relationship between active loyalty and its two antecedents, perceived program value and switching costs. The study empirically investigates influential program value signals that affect switching costs, and identify the stable role of switching costs when holding other control variables. The results distinguish the impact between perceived program values and switching costs as well as show a stronger role of switching costs on active loyalty compared to the perceived program values. switching costs show a stable effect on active loyalty when holding these individual variables. This finding provides strong justification for increasing switching costs in order to build customer retention, particularly at the time that loyalty erodes quickly in the competition market.

Although this study does not find a significant impact by the perceived program value on the active loyalty, customers are still commonly viewed as value seekers who wish to reap benefits from the loyalty programs. Instead of aggressively spending money or copying schemes from competitors (Dowling & Uncles, 1997), hoteliers may wish to carefully craft the program value that make a consistent match with the defensive strategy. This study, for example, identifies that functional value and psychological value are robustly related to switching costs. On the other hand, economic value does not necessarily contribute to customer retention. It might be a plausible explanation that customers nowadays focus more on utilizing additional benefits that recognize self-image or status than just on looking at

monetary or gift rewards. For example, a hotel marketer can offer its best or most loyal customers such additional benefits as preferential access to special parties, free alterations, early boarding privileges on planes, availability of personal shoppers, and special customer support phone numbers (Berman, 2006). These benefits may be perceived as more valuable and effective, which in turn enhances psychological costs of switching from the existing loyalty program.

Conclusion

While much of the literature has linked various factors to positive outcomes of customer loyalty, the novelty of this study it to show the important role of switching costs. That is to say, the theoretical framework built up around perceived program value and active loyalty needs to incorporate switching barriers (Bendapudi & Berry, 1997). This study contributes to the role of switching costs, identifying mechanism for magnifying active loyalty, and demonstrating complementarities and correlations between perceived value and switching costs.

Figure 1. The Research Framework

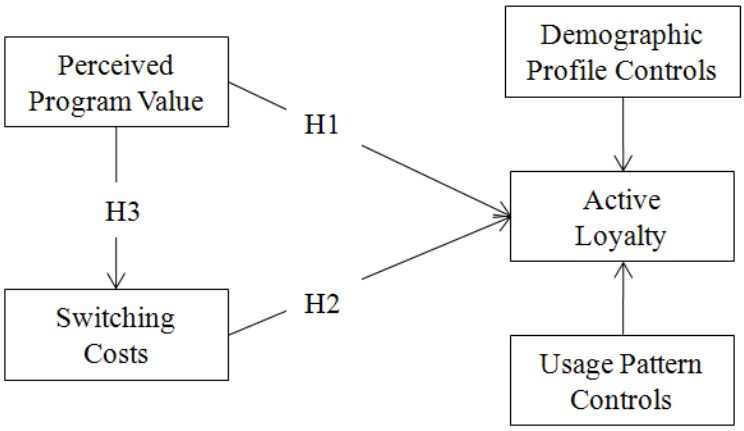

Figure 2. Results of the Research Model

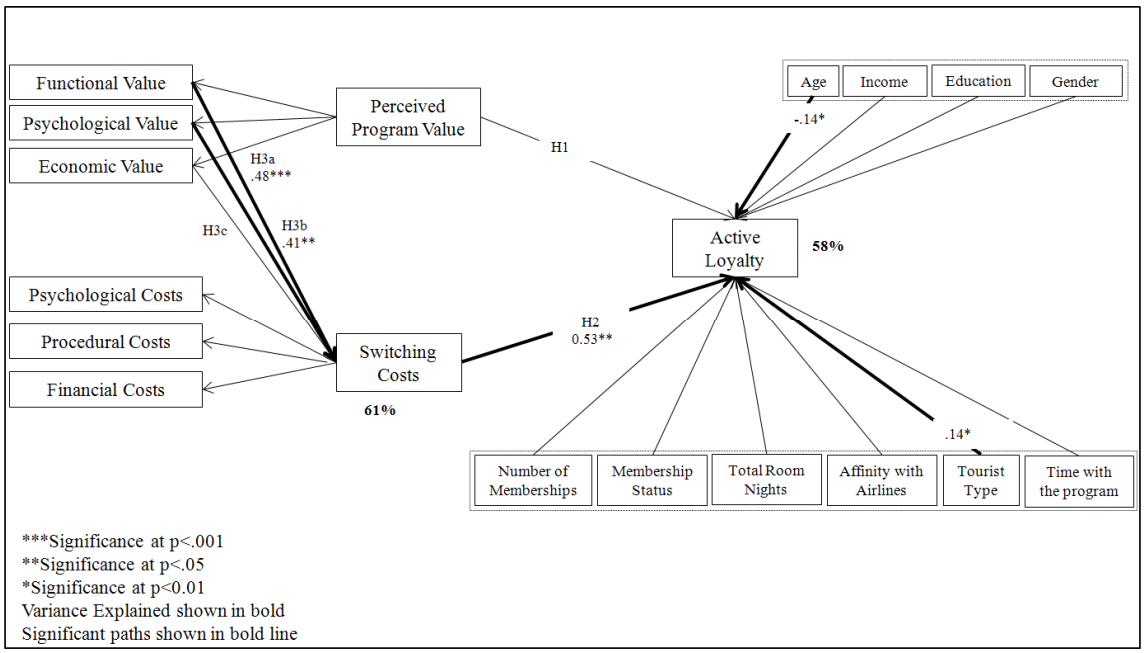

Table 2. Correlations (Squared Correlation), Reliability, AVE, and Mean

	PPV1	PPV2	PPV3	SC1	SC2	SC3	AL
PPV1	1.00						
PPV2	.45(.20)	1.00					
PPV3	.31(.10)	.46(.21)	1.00				
SC1	.33(.11)	.52(.27)	.31(.09)	1.00			
SC2	.47(.22)	.40(.16)	.45(.08)	.45(.27)	1.00		
SC3	.40(.16)	.06(.00)	.19(.04)	.24(.06)	.33(.11)	1.00	
AL	.40(.16)	.55(.31)	.28(.08)	.45(.20)	.40(.16)	.26(.07)	1.00
Reliability	0.89	0.86	0.86	0.84	0.78	0.77	0.88
AVE	0.59	0.56	0.70	0.60	0.68	0.54	0.59
Mean	4.57	3.61	3.62	3.33	3.79	3.85	0.73

Std. Dev.	0.61	0.89	1.05	0.89	0.81	0.99	0.78

Note: PPV1= Functional Value, PPV2= Pychological Value, PPV3= Economic Value, SC1= Psychological Swtiching Costs, SC2= Procedural Switching Costs, SC3= Financial Swtiching Costs, AL=Active Loyalty. All correlations are significant at p<.01.

Table 3. Results of Confirmatory Factor Analysis

Factors	Factor Loading	t-value	S.E
Factor 1: Functional Value (PPV1)			
FV 1 Easy to understand the reward program.	0.73		
FV 2 No processing fee for reward transfer.	0.71	9.64	0.12
FV 3 Reasonable rewards for what I spend.	0.84	11.48	0.11
FV 4 Points I have accumulated never expire.	0.79	10.77	0.10
FV 5 Easy to achieve reward redemption.	0.84	11.52	0.12
FV 6 No blackout dates to redeem free nights.	0.68	9.13	0.14
Factor 2: Psychological Value (PPV2)			
PV 1 Availability of special rewards (e.g., a luxury spa treatment, a cruise trip, etc.).	0.71		
PV 2 Easy to upgrade to a higher elite level.	0.76	9.66	0.11
PV 3 Proud of being a member.	0.73	9.31	0.13
PV 4 Privileges offered at an elite level.	0.79	10.07	0.11
Factor 3: Economic Value (PPV3)			
EV 1 Ability to transfer points to someone I know.	0.88		
EV 2 Ability to combine hotel points and airline miles.	0.64	10.10	0.07
EV 3 Convenience to transfer my reward points to someone I know.	0.96	16.20	0.07
Factor 4: Psychological Switching Costs (SC1)			
PSC 1 My friends and/or family are also members of my “old” program.	0.66		
PSC 2 I am comfortable interacting with staff working in my “old” program.	0.73	8.53	0.13
PSC 3 I appreciate the brand image of my “old” program.	0.90	9.35	0.14
Factor 5: Procedural Switching Costs (SC2)			
PSC 1 Learning features of the new program requires little time and efforts.	0.68		
PSC 2 The new program promises me to get monetary rewards..	0.73	9.41	0.11
PSC 3 The new program fits me well.	0.90	11.45	0.11
PSC 4 The new program takes little time and efforts to evaluate.	0.84	13.22	0.09
PSC 5 The new program is easy to get familiar with.	0.95	11.94	0.11
Factor 6: Economic Value (SC3)			
SC 1 The new program involves hidden costs/charges.	0.75		
SC 2 The new program causes me unexpected inconvenience.	0.65	7.77	0.10
SC 3 The points I have accumulated in my “old” program will not be retained.	0.79	8.68	0.12
Factor 7: Active Loyalty			
AL 1 I would take full advantage of any opportunities to accumulate points and redeem rewards.	0.79		
AL 2 Whenever there is a need again, I will choose my reward program’s hotel.	0.87 0.85	13.21 12.82	0.08 0.08
AL 3 If there is a need, I intend to continue staying at my reward program’s hotel.	0.72 0.50	10.41 6.82	0.10 0.12
AL 4 I would like to recommend my hotel reward program to others.			
AL 5 I am willing to pay more to stay in my reward program’s hotel, even when other hotels charge less.	0.82	12.24	0.10
AL 6 I frequently use my reward program for making reservations, accumulating points, and redeeming rewards.			

Note: All factor loadings are significant at p<.000.

Table 4 Two-factor PPV and SC Model with Control Variables (Full Model): Effects on AL

	Standardized Estimates					*t*-value	*p*	Conclusion
	FV	PV	EV	PPV	SC			
Hypothesis 1	_-___	-	-	0.25	-	1.74	0.082	Not Supported
Hypothesis 2	-	-	-	-	0.527	3.09	**	Supported

Hypothesis 3a	0.484	-	-	-	-	3.64	***	Supported
Hypothesis 3b	-	0.405	-	-	-	3.107	**	Supported
Hypothesis 3c	-	-	0.018	-	-	0.218	0.877	Not supported
Hypothesis 4	-	-	-	-	-			Supported
Control Variables								
Number of Memberships					0.00	-0.04	0.97	
Time with the program					0.06	0.90	0.37	
Tourist Type					0.14	2.33	*	
Affinity with airlines					-0.04	-0.66	0.51	
Membership Status					0.04	0.70	0.49	
Total Room Nights					0.08	1.37	0.17	
Income					-0.01	-0.08	0.94	
Education					0.00	0.03	0.97	
Age					-0.14	-2.38	*	
Gender					-0.07	-1.14	0.26	
Model Fit								
$\chi^2 = 1346.21$, $df = 716$, RMSEA = 0.07, CFI = 0.84, TLI = 0.83								

NOTE: Dash (—) indicates that relationship is not hypothesized. CFI = Comparative Fit Index; Tucker Lewis Index=TLI; RMSEA= root mean square error of approximation. *$p < .05$, one-tailed. **$p < .01$, one-tailed. ***$p < .001$, one-tailed.

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